

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
D. LYNN SMITH	:	DETERMINATION
	:	DTA NO. 819439
for Revision of a Determination or for Refund of Sales	:	
Use Taxes under Articles 28 and 29 of the Tax Law for	:	
the Period March 1, 1995 through November 30, 1997.	:	

Petitioner, D. Lynn Smith, P.O. Box 96, High Shoals, North Carolina 28077, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1995 through November 30, 1997.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on April 26, 2004 at 10:30 A.M. with all briefs to be submitted by August 3, 2004, which date commenced the six-month period for issuance of this determination. Petitioner appeared *pro se*. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Jennifer A. Murphy, Esq., of counsel).

ISSUES

I. Whether petitioner has shown that the audit method was unreasonable or that the audit results were incorrect.

II. Whether the Division of Taxation properly asserted fraud penalties against petitioner.

FINDINGS OF FACT

1. Petitioner, D. Lynn Smith, and her husband, Earl Smith, operated a retail liquor store under the corporate name of Nu-Bien Taste, Inc. ("Nu-Bien"). The name "Two Steps Liquors

and Wine” appeared on the facade of the building. The store, which was approximately 15 feet wide and 30 feet deep, was poorly stocked. It was located in a depressed area made up of residential and commercial buildings.

2. At the outset of the audit, the Division sent an appointment letter requesting access to the liquor store’s books and records. The letter asked that the liquor store have all of its books and records pertaining to its sales and use tax liability for the period under audit, March 1, 1995 through November 30, 1997, available on the appointment date including “financial statements, journals, ledgers, sales invoices, purchase invoices, cash register tapes, sales and use tax returns, federal income tax returns, and exemption certificates.”

3. The records that were requested but not made available included depreciation schedules, general ledger, sales journal, cash receipts journal, sales invoices, purchase journal, check disbursement journal, cancelled checks, bank deposit slips, monthly bank statements, resale certificates and exempt organization certificates. The Division noted that most of the liquor store’s sales tax returns were untimely and filed without remittance. However, the Division ascertained that during the period in issue, the liquor store changed its cash register system. From March 1, 1995 through a portion of October 1995 the liquor store used a cash register which produced a cash register tape. During October 1995, a scanning cash register system became operational. Petitioner was able to offer the auditor cash register tapes from March 1, 1995 through a portion of October 1995. Upon reviewing the cash register tapes, the Division noted that sales tax was not separately charged. For the balance of the audit period, petitioner made available detailed summaries from the scanning cash register system. Cash register tapes for some days were missing during the transition from one cash register system to another.

4. Since detailed sales records were available, the liquor store's sales records were deemed adequate to determine the amount of tax due on the audit. Therefore, purchases per books or purchases per suppliers were not used to calculate the sales tax liability. However, before deciding on the audit methodology, the auditor discovered that the purchases of the liquor store, according to its suppliers, were \$285,913.18 greater than the sales of \$131,243.00 which were reported by the liquor store on its sales and use tax returns for the period March 1, 1995 through August 31, 1997.

5. The auditor prepared a detailed transcript from the cash register tapes for the period March 1, 1995 through a portion of October 1995 and a sales tax payable transcript from the daily sales summary reports for the period October 1995 through November 30, 1997. Thereafter, the amount of sales tax due for the period March 1, 1995 through October 30, 1995 was determined on the basis of the difference between the sales per the transcript and the sales per the sales tax returns.¹ For the month of November 1995, the Division located and used a monthly summary showing total sales for the month. This amount was also compared to the reported gross sales to determine the amount of tax due. This analysis resulted in additional taxable sales of \$139,627.23. Since the auditor was not provided with any evidence of exempt sales, all sales were considered taxable. A sales tax rate of 8.25 percent was applied to the deficiency resulting in additional tax due of \$11,519.24.

6. The scanning cash register which the liquor store began using in October 1995 provided details regarding the individual sales, sales tax payable, cost and a daily summary of the foregoing items. For the period December 1, 1995 through November 30, 1997, the amount of tax determined to be due was based upon the difference between the sales tax payable

¹ It appears that sales tax was not found due for those days where cash register tapes were missing.

account, per the scanning cash register, and the sales tax which was reported to be due.

According to these reports, sales tax in the amount of \$30,103.83 was collected but the sales tax liability reported on the returns was \$7,542.00 resulting in a deficiency of \$22,561.83. For the entire audit period, the total deficiency was \$34,081.07.

7. On the basis of the foregoing audit, the Division issued a Notice of Determination (assessment # L-020994079), dated May 28, 2002, to petitioner which assessed sales and use taxes for the period March 1, 1995 through November 30, 1997 in the amount of \$34,081.07, plus interest in the amount of \$47,866.67 and penalty in the amount of \$44,381.96 less payments or credits of \$1,636.00 for a balance due of \$124,693.70. The penalty was assessed for fraud because petitioner had pled guilty to a charge of fraud.

8. In the course of the audit, Mr. Smith told the Division that some of the tax returns were prepared by a prior accountant, some were prepared by a current accountant and some were prepared by petitioner. Petitioner signed the sales and use tax returns which are in the record. The auditor was not told what information the returns were based on.

9. On August 12, 1998, the business and its assets were seized and the inventory was sold at an auction. At the time of the seizure, the business was struggling.

10. Cases may be referred to the Revenue Crimes Bureau ("RCB") by the Division for criminal investigation. In this case such a referral occurred and an investigation was conducted. Following the investigation, the investigators concluded: that petitioner was a responsible officer of Nu-Bien; that Nu-Bien substantially underreported the sales tax due on the sales tax returns which were filed for the period in issue; that the sales per Nu-Bien's books and records substantially exceeded the sales reported on Nu-Bien's sales tax returns; that Nu-Bien's purchases of liquor were substantially in excess of sales reported on Nu-Bien's sales tax returns;

that Nu-Bien failed to file U.S. corporate income tax returns and New York State withholding tax returns for the period in issue; that Nu-Bien did not file New York State franchise tax reports for the years 1994, 1995 and 1997; and that, although cash register tapes were presented to the civil auditor, Nu-Bien failed to produce records during the RCB investigation and did not know the whereabouts of other records during the RCB investigation. The investigators also determined that during the first nine months of the period in issue, \$143,190.00 was deposited in Nu-Bien's bank account while sales were \$198,289.00. During the same nine months, the sales reported on Nu-Bien's sales tax returns were \$39,186.00.

11. As a result of the investigation, petitioner was charged with grand larceny in the third degree, grand larceny in the fourth degree, offering a false instrument for filing in the first degree and filing fraudulent returns, reports, statements or other documents for sales and compensating use tax.

12. On October 18, 2000, petitioner signed a plea agreement stating that between the dates of approximately March 1, 1995 and April 10, 1998, petitioner's company, Nu-Bien Taste, Inc., collected sales tax in the amount of \$43,635.82. During the same period petitioner completed and filed sales tax returns with the New York State Tax Department in New York County, and elsewhere, and that in these returns, petitioner, knowing that the information was not true and correct, underreported gross taxable sales by \$397,676.00 and failed to remit the corresponding sales tax due in the amount of \$33,169.21. On the same date, petitioner also executed an affidavit which confessed judgement in favor of the Department of Taxation and Finance in the amount of \$33,169.21. In furtherance of the foregoing agreements, petitioner pled guilty to one count of making fraudulent returns, reports, statements or other documents for sales and compensating use tax for the period March 1, 1995 through April 10, 1998 in violation of Tax

Law § 1817(b). Petitioner entered this plea because she reasoned that, as the owner, she was responsible.

13. The stock of Nu-Bien was owned by petitioner and her husband. Petitioner was the president of the corporation.

14. Prior to the audit, petitioner did not have any reason to check the accuracy of the computer program. Neither petitioner nor her husband confirmed the accuracy of the inventory record.

SUMMARY OF THE PARTIES' POSITIONS

15. At the hearing, petitioner questioned the accuracy of the computer program. However, she did not have any documents to show that the computer system was inaccurate.

16. The Division argues: that a detailed audit of the corporation's records revealed additional taxable sales; that petitioner is a responsible officer of the corporation; that petitioner's conviction collaterally estops her from challenging the civil fraud penalty; that the evidence establishes that petitioner committed tax fraud; and that the imposition of other penalties as an alternative to the fraud penalty is required if it is determined that the Division has not carried its burden of proof of fraud.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax on the receipts of every "retail sale" of tangible personal property except as otherwise provided in Article 28 of the Tax Law. A "retail sale" is a "sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . ." (Tax Law § 1101[b][4][i][A]). Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed was incorrect or insufficient, the amount of tax due shall be determined [by the Division of Taxation] from such information as

may be available. If necessary, the tax may be estimated on the basis of external indices . . .” (Tax Law § 1138[a][1]).

B. In this case, the Division did not use an external index to estimate sales. Rather, in order to determine sales the Division relied upon the records of the liquor store, i.e., the cash register tapes and the scanning cash register system. Further, in the absence of any evidence to the contrary, the Division properly presumed that all of the receipts were subject to tax (Tax Law § 1132; *see, Matter of Petak v. Tax Appeals Tribunal*, 217 AD2d 807, 629 NYS2d 547; *Matter of Academy Beer Distribs. v. Commr.*, 202 AD2d 815, 609 NYS2d 108, *lv denied* 83 NY2d 759, 616 NYS2d 14).

C. In order to warrant an adjustment, petitioner would have to present clear and convincing evidence that the audit methodology was flawed (*Matter of Sol Wahba, Inc. v. State Tax Commn.*, 127 AD2d 943, 512 NYS2d 542; *Matter of Surface Line Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451) or that the audit results were inaccurate (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842, 502 NYS2d 113). Petitioner’s bare assertion that the scanning computer system may not have been accurate does not meet this burden. To the contrary, the audit methodology chosen by the Division appears to be very accurate.

D. Tax Law former § 1145(a)(2) provided in pertinent part:

If the failure to pay or pay over any tax to the commissioner of taxation and finance within the time required by this article is due to fraud, in lieu of the penalties and interest provided for in subparagraphs (i) and (ii) of paragraph one of this subdivision, there shall be added to the tax (i) a penalty of fifty percent of the amount of the tax due, plus (ii) interest on such unpaid tax. . . .

E. Whether petitioners fraudulently failed to pay sales tax to the Division or filed willfully false or fraudulent returns with the intent to evade payment of tax are questions of fact to be determined upon consideration of the entire record (*Jordan v. Commissioner*, 52 TCM 234).

The burden of demonstrating this falls upon the Division (*Matter of Sona Appliances*, Tax Appeals Tribunal, March 16, 2000). However, a finding of fraud requires the Division to show “clear, definite, and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in deliberate nonpayment or underpayment of taxes due and owing” (*Matter of Sona Appliances, supra*).

F. The record shows that the amount of tax due was calculated from the liquor store’s records. Therefore, petitioner knew or should have known the amount of tax that was required to have been reported and paid. However, petitioner followed a pattern of filing sales tax returns which substantially understated the liquor store’s sales tax liability. This practice continued throughout the audit period.

Petitioner pled guilty to one count of willfully making and subscribing fraudulent returns, reports, statements or other documents which are required to be filed or furnished for sales and compensating use tax for the period March 1, 1995 through April 10, 1998 in violation of Tax Law § 1817(b). The guilty plea to fraudulent conduct covers the same period in issue here and estops petitioner from arguing that the fraud penalty was improperly asserted (*see, Matter of T. Management, Inc.*, Tax Appeals Tribunal, April 12, 2001; *Matter of DeFeo*, Tax Appeals Tribunal, April 22, 1999). Accordingly, it is concluded that petitioner committed fraud by willfully filing false sales tax returns resulting in an underpayment of sales tax.

G. The Division’s argument that petitioner is a responsible officer of the corporation has not been addressed since petitioner has not challenged the Division’s assertion that she is responsible for the sales and use taxes due from the corporation. Further, since the fraud penalty

has been sustained, the Division's argument, in the alternative, for the imposition of negligence penalties is moot.

H. The petition of D. Lynn Smith is denied and the Notice of Determination, dated May 28, 2002, is sustained together with such penalty and interest as is lawfully due.

DATED: Troy, New York
January 20, 2005

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE